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Nos. 84-871, 84-889, 84-1054, and 84-1069

In The
Supreme Court of the United States
October Term, 1984

Louisiana Public Service Commission, Appellant
v.
Federal Communications Commission and
United States of America

California and Public Utilities Commission
of California, et al., Petitioners
v.
Federal Communications Commission and
United States of America

Public Utilities Commission of Ohio,
et al., Petitioners
v.
Federal Communications Commission and
United States of America

Florida Public Service Commission, Petitioner
v.
Federal Communications Commission and
United States of America

On Appeal And On Petitions For A Writ Of Certiorari To The United States Court Of Appeals For The Fourth Circuit

REPLY BRIEF OF APPELLANT, THE LOUISIANA PUBLIC SERVICE COMMISSION, AND PETITIONERS, THE PUBLIC UTILITIES COMMISSION OF OHIO AND THE OHIO OFFICE OF CONSUMERS' COUNSEL

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TABLE OF CONTENTS

	Page
TABLE OF CONTENTS	i
TABLE OF AUTHORITIES	ii
ARGUMENT	1
CONCLUSION	20
APPENDIX A	App. 1

TABLE OF AUTHORITIES

CASES: Page

American Tel. & Tel. Co. v. United States, 299 U.S. 232 (1936) 5, 9, 10

Federal Pow. Com'n v. Hope Nat. Gas Co., 320 U.S. 591 (1944) 18

Fidelity Fed. Sav. and Loan Ass'n v. de la Cuesta, 458 U.S. 141 (1982) 19

Interstate Comm. Com'n v. Goodrich Trans. Co., 224 U.S. 194 (1912) 7, 9

Kansas City So. Ry. Co. v. Commissioner of Int. Rev., 52 F.2d 372 (8th Cir. 1931) 10

Lindheimer v. Illinois Bell Tel. Co., 292 U.S. 151 (1934) 4, 5, 6, 12, 13

Minnesota Rate Cases, 230 U.S. 352 (1913) 4

Rice v. Santa Fe Elevator Corp., 331 U.S. 247 (1947) 19

Smith v. Illinois Bell Tel. Co., 282 U.S. 133 (1930) 14

State of Missouri ex rel. Southwestern Bell Tel. Co. v. Public Serv. Com'n, 262 U.S. 276 (1923) 3

United Rys. & Elec. Co. v. West, 280 U.S. 234 (1930) 4

STATUTES:

47 U.S.C. §§ 152(b) 12

47 U.S.C. § 153(e) 12

47 U.S.C. § 213(h) 12

47 U.S.C. § 220(j) 13

47 U.S.C. § 221(b) 12

47 U.S.C. § 410(c) 14

TABLE OF AUTHORITIES—Continued

Page

ADMINISTRATIVE DECISIONS:

Amend. of Part 31, 89 F.C.C.2d 1094 (1982) 3, 7, 10, 12, 15

Depreciation Charges of Tel. Cos., 118 I.C.C. 295 (1926) 6, 12

Depreciation Charges of Tel. Cos., 177 I.C.C. 351 (1931) 4

Prescription of Revised Percentages of Depreciation, 96 F.C.C.2d 257 (1983) 18

Re Michigan Bell Tel. Co., Docket No. U-7473 (Mich. P.S.C. 1982) 16

Re New England Tel. & Tel. Co., 35 PUR3d 100 (Vt. P.S.C. 1960) 7

Re New York Tel. Co., 20 PUR3d, 129 (N.Y.P.S.C. 1957) 7

Re South Cent. Bell Tel. Co., Docket No. U-15955 (La. P.S.C. 1984) 16

MISCELLANEOUS:

78 Cong. Rec. 882 *et seq.*, 10312 *et seq.* 6

78 Cong. Rec. 8823 12

78 Cong. Rec. 10312 *et seq.* 6

117 Cong. Rec. 28906 14

H.R. Rep. No. 1850, 73d Cong., 2d Sess. 6

S. Rep. No. 781, 73d Cong., 2d Sess. 6, 12

Hearings on H.R. 8301 before House Committee on Interstate and Foreign Commerce, 73d Cong., 2d Sess. 6, 12, 13

TABLE OF AUTHORITIES—Continued

	Pages
Hearings on S. 2910 before the Senate Committee On Interstate Commerce, 73d Cong., 2d Sess.	6
S. 3285, 73d Cong., 2d Sess. § 220(j)	13
1983 Moody's Pub. Util. Man. 233	18
1985 Ann. Rep., BellSouth Corp.	18

This reply brief is submitted on behalf of the appellant and petitioners in Nos. 84-871 and 84-1054[1] to address the arguments of the FCC and United States (collectively, "the Government"), AT&T, the Bell companies and other telephone companies (collectively, "telephone companies"), and GTE Service Corp. ("GTE"), appellees-respondents (collectively, "respondents").

ARGUMENT

Four major contentions of the respondents require responses. First, the Government and the telephone companies attempt to belittle the argument that Section 220 is a reporting provision and not binding for ratemaking, but offer no meaningful response. Second, the respondents present a fallacious picture of the language and legislative history of the Communications Act. They assert that the compromise over Section 220(j)—which was originally designed to give the States plenary authority over accounting—had the effect of eliminating virtually all State ratemaking perogatives.

Third, the respondents assert that Congress meant to give the States virtually no ratemaking authority in the Communications Act. They contend that the States can regulate "purely intrastate" plant, but simultaneously argue that there is no such plant. Alternatively, they say that Congress gave the States authority only over rate design and other minor matters—a revolutionary interpretation of the Act. Fourth, the respondents raise a flurry of warnings that the telephone companies, which already were among the richest and strongest companies in the nation when the *Preemption Decision* was issued, would not be willing or able to modernize without accelerated

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[1] Because of the time limitation, this brief could not be consolidated with a draft being prepared by the Florida Public Service Commission, although we support the positions asserted therein. This brief employs the same abbreviations of legislative history citations as were used in our first brief.

capital recovery. These arguments do not justify the *Preemption Decision*.

1. The Government and telephone companies have no substantive answer to the point that accounting practices, including depreciation, have never been deemed binding for ratemaking, so they react with scorn. The Government labels our argument "frivolous." (Br. 34). The telephone companies deride our authorities as "scraps," purportedly presented in a "jumble[d]" fashion, and contend that we cite only one on-point depreciation case. No party offers any authority, nor any sound argument, showing that FCC accounting or depreciation prescriptions do bind State ratemakers. Indeed, in their footnotes the Government and the telephone companies *concede* that State ratemakers are not bound by FCC accounting practices, but attempt to distinguish depreciation from accounting. (Gov. br. 34 n.32; Telcos. br. 20 n.54). GTE also attempts to draw this distinction. (GTE br. 13). No valid reason exists to adopt this argument, which would overrule the existing law and tie the hands of regulators in a manner that Congress did not intend.

The Government concedes that the "uniform accounting system . . . often does not govern ratemaking" and that a claimed expense may be disallowed "in part or in whole because it is excessive or unreasonable, or . . . contrary to sound ratemaking policy." (Br. 34 n.32). It employs artful language in distinguishing depreciation, saying that accounting does not bind ratemaking, but depreciation "clearly is binding *on carriers* for ratemaking." (*Id., emphasis supplied*) The telephone companies indicate in text that the State ratemakers are bound by *all* FCC accounts, but concede in a footnote that properly classified expenses may be disallowed by ratemakers. (Br. 13, 20 n.54). Like the Government, the telephone companies and GTE attempt to distinguish depreciation from accounting (Telcos. br. 21; GTE br. 13).

The concession that accounting does not bind ratemaking establishes that Section 220 does not prohibit separate intrastate records. If ratemaking adjustments are made to the books of a carrier, separate records are necessary to ensure a consistent basis for ratemaking in the future, as the FCC recognized in its initial preemption decision. *Amend. of Part 31*, 89 F.C.C.2d 1094, 1098 (1982), J.S. App. at A-67. Thus, the concession encompasses ratemaking *and* recordkeeping.

None of the appellees provides authority for the claimed distinction between accounting and depreciation. They urge the Court to create this exception because a) Congress assertedly paid a lot of attention to the depreciation provisions in 1934, indicating Congress "understood" these provisions governed rates; b) depreciation accounting purportedly played the "central role" in the economic regulation of carriers when Congress enacted Section 220(b); c) accounting prescriptions supposedly are more "general" than depreciation prescriptions; and d) we assertedly cite insufficient authority—"exactly *one* reported case"—approving a State deviation from an FCC depreciation practice. (Gov. br. 34; Telcos. br. 20; GTE br. 13; Telcos. br. 21). These arguments are meritless.

First, contrary to the claims of the respondents, the distinction between depreciation accounting and ratemaking was well established in 1934. Respondents forget that the computation of rate base *and* depreciation for ratemaking was based on *fair value* pursuant to the decisions of this Court; the computation of rate base and depreciation under the ICC uniform system of accounts was based on original cost. This Court had repeatedly rejected the theory that original cost methods should determine economic regulation. Thus, Congress could not have believed that FCC depreciation prescriptions would bind ratemakers any more than other FCC accounting practices.

At the time the Act was passed, this Court required regulators to base ratemaking decisions on the "fair value" of the plant of a utility. *State of Missouri ex rel.*

Southwestern Bell Tel. Co. v. Public Serv. Com'n, 262 U.S. 276, 287 (1923); *Minnesota Rate Cases*, 230 U.S. 352, 454 (1913). The fair value approach gave great weight to the replacement cost of plant, which could be higher or lower than original cost less depreciation. The Court also mandated that the depreciation allowed as an expense be based on present value, or replacement cost, rather than original cost. Thus, in *United Rys. & Elec. Co. v. West*, 280 U.S. 234 (1930), the Court overruled a rate order of a state commission that made a depreciation allowance based on original cost. It stated: "The allowance for annual depreciation made by the Commission was based upon cost. The Court of Appeals held that this was erroneous and that it should have been based upon present value. The court's view of the matter was plainly right . . . ." *Id.* at 253.

In 1931, in *Depreciation Charges of Tel. Cos.*, 177 I.C.C. 351 (1931), an ICC depreciation case that the telephone companies and GTE claim preempted state ratemaking, the ICC considered whether the federal accounting rule should be consistent with the Court's ratemaking rule. The ICC recognized that the Court's decision was inconsistent with ICC accounting practices. *Id.* at 373-74. Nevertheless, the ICC reaffirmed the original cost depreciation approach on the theory that it was merely performing an "administrative function." *Id.* at 380. It said: "It is not essential that the accounts should correspond in all respects with the facts which may be controlling in a confiscation case." *Id.* at 381. Since the original cost depreciation method was an accounting practice and not a ratemaking rule, the ICC concluded that it "does not contravene decisions of the Supreme Court." *Id.* at 382.

In April, 1934, *while the Communications Act was under consideration in Congress*, the Court decided *Lindheimer v. Illinois Bell Tel. Co.*, 292 U.S. 151 (1934). In that case, the Illinois Commission disallowed part of the

booked depreciation expense of the company. The Court noted that "the company has used the 'straight line' method of computation, a method approved by the Interstate Commerce Commission." *Id.* at 167-68. Nevertheless, the Court affirmed the decision of the state agency, ruling that the company had not proven the need for the allowance reflected on its books. It stated:

> Confiscation being the issue, the company has the burden of making a convincing showing that the amounts it has charged to operating expenses for depreciation have not been excessive. That burden is not sustained by proof that its general accounting system has been correct. [Calculating depreciation] involves the examination of many variable elements and opportunities for excessive allowances, even under a correct system of accounting, are always present. *Id.* at 169-70.

Given the inconsistency between "original cost" accounting and the "fair value" ratemaking principle established by the Court, along with the explicit holding that the Illinois Commission properly deviated from the depreciation practice prescribed by the ICC, Congress could not have believed that the FCC depreciation authority taken from the Interstate Commerce Act would bind intrastate ratemakers. The non-binding nature of depreciation prescriptions was explicitly determined. The FCC undoubtedly recognized this fact after its creation, because it assured the Court in *American Tel. & Tel. Co. v. United States*, 299 U.S. 232, 240-42 (1936), a case involving the computation of ***investment*** and ***depreciation***, that accounting practices would not necessarily determine ratemaking treatment. The telephone companies concede this construction of *AT&T*, but imply that it involved expense issues other than depreciation. (Br. 20 n.54).

Second, it is not true that Congress paid undue attention to the depreciation issue. Section 220 received scant attention in the House and Senate reports, took up

relatively little time in committee hearings, and got virtually no attention in floor debates. The ICC comments devote one short paragraph, of more than 120, to Section 220(j), and did *not* oppose the provision. The members of Congress were much more interested in controlling monopoly power, keeping rates low, and preserving state jurisdiction than they were in accounting. H.R. Rep. at 7; S. Rep. at 5; S. Hearings at 94-97, 180-84, 205; H.R. Hearings at 96, 137-44, 185-91, 243, 246, 249; 78 Cong. Rec. 8822 *et seq.*, 10312 *et seq.* (1934), H.R. Hearings 165-202; 78 Cong. Rec. 8823 (1934).

Third, there is no basis for distinguishing depreciation on the ground that other accounting prescriptions are "general." In 1934, this Court ruled in *Lindheimer* that depreciation accounting was too inexact to bind ratemakers individual cases. Moreover, the ICC had ruled, in a case cited by the respondents, that "uniform rates of depreciation cannot be established for all telephone companies," and had delegated the task of determining individual company rates to the State commissions. *Depreciation Charges of Tel. Cos.*, 118 I.C.C. 295, 332 (1926). Since the ICC deemed itself incapable, as a practical matter, of prescribing accurate depreciation rates for individual companies, Congress could not have assumed that FCC prescriptions would be more exact than other accounting entries.

Fourth, the telephone companies reveal a stark inconsistency when they sarcastically assert that we found "exactly *one* reported case" on depreciation. (Br. 21). On the one hand, they repeatedly assure the Court that the FCC decision on expensing versus capitalization of station connections is, truly, a "depreciation" decision. (Br. 1, 6, 7 n.18, 9, 35). On the other hand, they claim that our authorities on expensing versus capitalization of research and development costs, and interest during construction, are not "depreciation" decisions. This inconsistency is

not indicative of a logical position. In any event, in addition to the Court's decisions, other authorities establish that FCC depreciation practices are not binding for intrastate ratemaking. *Re New York Tel. Co.*, 20 PUR3d 129, 143 (N.Y.P.S.C. 1957) (Commission can deviate from FCC depreciation prescriptions "for the purpose of determining what are fair charges to operating expenses"); *Re New England Tel. & Tel. Co.*, 35 PUR3d 100, 105 (Vt. P.S.C. 1960) (FCC depreciation order disregarded for intrastate ratemaking). Indeed, the FCC itself issued an administrative statement in 1980 that its depreciation prescriptions did not bind the New York Commission for ratemaking. (App. A).

Fifth, the Government makes a drastic turnabout in calling our argument "frivolous." In its first decision on the preemption issue, the FCC pointedly referred to the limited function of *all* accounting rules, holding that these rules do not preclude ratemaking adjustments. *Amend. of Part 31*, 89 F.C.C.2d 1094, 1099 (1982), J.S. App. at A-67-A-68, A-70). It cited *Interstate Comm. Com'n v. Goodrich Trans. Co.*, 224 U.S. 194 (1912), where the Court stated that the ICC needed *information* to accomplish its regulatory task. The Court added:

> The object of requiring such accounts to be kept in a uniform way . . . is not to enable [the ICC] to regulate the affairs of the corporations not within its jurisdiction, but to be informed concerning the business methods of the corporations subject to the act that it may properly regulate such matters as are really within its jurisdiction. *Id.* at 211.

The FCC concluded that construing Section 20 to limit state rate regulation "would have been inconsistent with the Court's description of the nature and function of the accounting rules." 89 F.C.C.2d at 1099, J.S. App. at A-69-

A-70. The FCC did not distinguish depreciation and other accounting, since the purported distinction was unheard of when its first decision on preemption was issued.

If the respondents really believe in their depreciation distinction, they are disingenuous in failing to deal with the fact that the *Expensing Order* makes an expense classification rather than a depreciation prescription. The respondents concede that expense classifications may be disallowed. Moreover, *every* expense classification embodies the implicit finding that the cost should not be capitalized and depreciated. In addition, the respondents' insistent reliance on Sections 220(h) and (i) is misplaced, since these provisions deal generally with accounts and do not mention depreciation.

Finally, the telephone companies attack our position by mischaracterizing it. We do not contend, as they say, that accounting and depreciation prescriptions are "irrelevant" to ratemaking. (Telcos br. 19). Books of account today serve as a relevant and useful *starting point,* but the figures may and should be adjusted when the evidence, or regulatory principle, requires. The respondents' argument would preclude these adjustments.

In order to uphold the *Preemption Decision*, the Court must not only prohibit intrastate recordkeeping, but overturn the universal rule that accounting precepts do not bind ratemakers. To support this action, the respondents argue that ratemakers have always been bound by Section 220(b). This argument is contrary to law, history and reason. When carried to its logical conclusion, the respondents' proposed rule would destroy virtually all state regulatory control over the revenues of utility companies. No basis exists to determine that Congress intended this result.

2. The respondents present a narrow, unrealistic picture of the statute and its legislative history in arguing

that Congress intended the FCC to raise intrastate rates through its accounting prescriptions. They argue that Section 220(b) is mandatory and exclusive — prohibiting carriers from keeping any supplemental records for any purpose without a specific authorization from the FCC. They assert that Section 220 is more specific than Section 2(b), and therefore controls it, and they brush aside or ignore other provisions protecting State jurisdiction. The respondents inaccurately portray the legislative history, contending that a compromise over Section 220(j) was actually a prescription for FCC regulation of intrastate rates. (Gov. br. 16, 24, 33, 27-31; Telcos. br. 13, 31, 15-19; GTE br. 12-13, 30, 13-24). These contentions are invalid.

The argument that Section 220(b) is mandatory — prohibiting carriers from maintaining any depreciation records for any purpose without an FCC authorization — is erroneous. Section 220(b) is no more mandatory than Sections 220(a) and (g), which, read expansively, would make it unlawful to keep any "accounts, records or memoranda" other than those prescribed or approved by the FCC. This sweeping construction is inconsistent with the rulings of this Court and the longstanding practice of carriers to keep many other records and accounts — including depreciation records — for other purposes.

Prior to the enactment of Section 220, this Court construed its model, Section 20 of the Interstate Commerce Act, as having a limited reach. The Court held that the accounting provisions were *not* designed to enable the ICC to regulate matters outside its jurisdiction, but to obtain information to "properly regulate such matters as are really within its jurisdiction." *Interstate Comm. Com'n v. Goodrich Trans. Co.*, 224 U.S. 194, 211 (1912). This limited construction was reaffirmed by the Court after Section 220 was passed. *American Tel & Tel. Co. v. United States,*

299 U.S. 232, 237 (1936). The limitation of Section 220, reflecting the implicit limitation contemplated by Congress, establishes that the provisions are mandatory only for interstate reporting purposes.

Moreover, the construction of the respondents would lead to absurd results. Carriers frequently maintain records that are not explicitly authorized by the FCC. The respondents' interpretation would preclude records or memoranda respecting personnel, civil rights, administration and other subjects. As the FCC itself observed in its first preemption ruling, their construction would "preclude carriers from using accelerated depreciation methods for purposes of computing their income taxes since such methods differ from the depreciation methods that have been prescribed for ratemaking purposes," and "restrict other forms of state or federal regulation that might require [different] accounting records or information. . . ." *Amend. of Part 31,* 89 F.C.C.2d 1094, 1100 (1982), J.S. App. at A-70. The FCC noted that a similar interpretation of the Interstate Commerce Act had been "summarily rejected" by a federal appeals court. *Id.*, citing *Kansas City So. Ry. Co. v. Commissioner of Int. Rev.*, 52 F.2d 372 (8th Cir. 1931).

The statutory interpretation of the respondents is also flawed. Their "specificity" argument actually reflects a major weakness: Section 220 is more *limited* than other sections because it deals only with accounting. Section 2(b) is very specific; it protects state jurisdiction over *charges,* the *classifications* and *practices* affecting charges, and *services, facilities* and *regulations.* Moreover, by providing that "nothing in this chapter" shall interfere with intrastate regulation, Section 2(b) limits the scope of Section 220 and every other provision in the Act. Indeed, Congress deemed it necessary to write exceptions into Section

2(b) for Sections 301 and 224, relating to radio and pole attachments; no exception exists for Section 220. In addition, Section 2(b) exempts "connecting" carriers from the requirements of Section 220 even if they carry interstate calls. Since these carriers have not been subjected to FCC reporting requirements, Section 2(b) *must* control over Section 220.

The respondents essentially ignore the provision in Section 3(e) that excludes *any* communication already regulated by a state commission, even if it crosses state lines, from the definition of "interstate communication." GTE makes an incongruous argument concerning Section 221(b), which contains a similar exclusion. It contrasts this section with Section 2(b), saying that Congress "knew how" to exclude FCC authority over jointly used plant regulated by the States because *it did so* in Section 221(b). (GTE br. 10). Given that concession, GTE does not explain how it hopes to prevail in this case.

Perhaps GTE implicitly relies on the interpretation of the telephone companies — that Section 221(b) applies to exchanges straddling state lines. (Telcos. br. 31 n.84). Yet this contention is also incongruous; Congress could not have intended to give the States less authority over jointly used plant *within* States than over jointly used plant in exchanges straddling State lines. Even if this contention were accepted, the application of the *Preemption Decision* to interstate metropolitan exchanges — such as the huge exchange covering Washington, D.C. and parts of Maryland and Virginia — would conflict with the *conceded* meaning of Section 221(b).

In their legislative history argument, the respondents misportray the context in which the Act was passed and misinterpret the compromise over Section 220(j). The telephone companies and GTE assert that the ICC had claimed exclusive power over accounting and depreciation

when the Act was passed. (Telcos. br. 16; GTE br. 15-16). But the ICC held only that it could prescribe depreciation practices and require the reporting of company-wide data; it did not hold that the States could not require their own depreciation reports. *Depreciation Charges,* 118 I.C.C. 295, 332 (1926). Indeed, the ICC specifically recognized that the States could prescribe depreciation rates; it had previously left two of its own accounts open "for use in the event that any of the state commissions prescribed depreciation accounting." *Id.* at 374. In its first decision on preemption, the FCC rejected the reading of the ICC decisions proferred by the telephone companies and GTE. *Amend. of Part 31,* 89 F.C.C.2d 1094, 1100-01 (1982), J.S. App. at A-71-A-72. Moreover, this Court in April, 1934 rejected the ICC depreciation practice for intrastate ratemaking in *Lindheimer v. Illinois Bell.*

In 1934, the ICC did *not* regulate telephone rates. The Senate report described ICC regulation of the telephone monopoly as "practically nil." S. Rep. at 2. The ICC had been unable to prescribe specific depreciation rates for telephone companies and asked the State commissions to make the prescriptions for it. *Depreciation Charges,* 118 I.C.C. 295, 374 (1926). State regulation applied to about 99 per cent of telephone communications. H.R. Hearings at 132. State representatives participated in drafting the Communications Act, inserting provisions much different from those in the Interstate Commerce Act, designed to preserve *all* existing State regulatory authority. 78 Cong. Rec. 8823; 47 U.S.C. §§ 152(b), 153(e), 221(b). The reservations included a provision protecting the right of State agencies to *value* the property of carriers, which necessarily involves depreciation. 47 U.S.C. § 213(h). These provisions were not changed or deleted.

The relatively minor dispute over Section 220(j) reflected an attempt by the States to eliminate any *possibility* of FCC intrusion into intrastate regulation. The

general solicitor of NARUC expressed the fear that, without the provision, an FCC prescription order "might be pointed to by the utilities" as binding the States. H.R. Hearings at 137. He asserted that this *potential argument* would be illogical, referring to *Lindheimer* and the ICC ruling that depreciation rates could only be prescribed on a case-by-case basis. *Id.* at 138-39. He asked for no particular language, not even the proposed language in Section 220(j), but some language to "make it clear" State powers were unhampered. *Id.* at 143.

No party opposing the original Section 220(j) ever suggested that changing the provision would curb State ratemaking prerogatives. The AT&T president objected to the provision because, in his view, it would require different accounts for different jurisdictions, precluding consolidated reporting by utilities on a uniform basis. H.R. Hearings at 191. The ICC agreed that the provision was inconsistent with uniform accounting. *Id.* at 96. These parties were concerned with preserving a primary system for reporting the affairs of carriers.

The compromise over Section 220(j) removed the House provision turning over primary accounting jurisdiction to the States, but it also eliminated the implication in the Senate version that legislation would be necessary to permit the States to prescribe accounting practices. S. 3285, 73d Cong. 2d Sess., § 220(j) (1934). Contrary to the respondents' claims, the final version is vastly different from the Senate version; it refers evenhandedly to harmonizing "the powers of the commission and of State Commissions" concerning accounting matters. 47 U.S.C. § 220(j). Moreover, Section 410(b) allows the FCC to "confer" with State commissions concerning "the relationship between [FCC and State] . . . accounts. . . ." This history and language cannot support a conclusion that Congress meant to preclude carriers from keeping any intrastate records.

In addition, Congress was aware of this Court's decision in *Smith v. Illinois Bell Tel. Co.*, 282 U.S. 133 (1930), requiring jurisdictional separations. In providing that the FCC could classify property to "be considered" as interstate, Congress prescribed the limit of FCC ratemaking jurisdiction. Like *Smith*, Section 221(c) openly contemplates the division of investment and costs for the same pieces of equipment. This provision destroys the argument that State and Federal depreciation rates on the equipment have to be the same. Similarly, when Congress passed the Federal-State Joint Board Act in 1971, it knew that the separations process would determine the limits of the respective ratemaking jurisdictions. *See* 47 U.S.C. § 410(c). The process was explained in the House as follows: "[T]he same plant, equipment, and expenses are in most instances involved in providing both intrastate and interstate telephone service. Hence plant and equipment are 'separated,' to use the jargon of the industry, for purposes of ratemaking." 117 Cong. Rec. 28906. The separations process accommodates differences in Federal and State ratemaking policies and makes prior court of appeals decisions — which approved preemption when irreconcilable conflicts existed — inapplicable here.

Finally, the Government contends that the FCC previously had "no occasion" to rule on the preemptive effect of its depreciation prescriptions and "there had been no direct challenges to the FCC's prescription orders." (Br. 25). This statement is inaccurate. One pointed example occurred in New York in 1980, when the telephone company claimed that FCC depreciation prescriptions were binding for ratemaking. This interpretation was brought to the attention of the FCC. Its Secretary responded:

> Please note that the rates that we prescribed must be used by NYTC for its financial reporting; however,

> decisions as to the ratemaking treatment of the expenses measured by application of these rates are matters more approproately [sic] addressed by the agency having specific jurisdiction. (App. A).

Moreover, the claims of the Government are generally inconsistent with the description of past practice by the FCC in its initial preemption ruling. *Amend. of Part 31,* 89 F.C.C.2d 1094, 1107 (1982), J.S. App. at A-82-A-83.

Section 220 provides a means to ensure that carriers report company-wide data on a uniform basis. It was not meant to hinder state ratemaking or preclude intrastate recordkeeping. This section does not justify the *Preemption Decision.*

3. Approval of the *Preemption Decision* would eviscerate virtually all State ratemaking authority. The logical consequence of the respondents' arguments is to reduce intrastate ratemaking to a formalistic acceptance of FCC-prescribed accounting data. The potential breadth of the FCC intrusion is demonstrated when the respondents claim that "purely" intrastate facilities are protected under Section 2(b), but simultaneously contend that there is no such thing. (GTE br. 24, 24-25; Telcos. br. 3, 2; Gov. br. 35, 3). By asserting that the States may preside over "rate design," the respondents implicitly contend that all but the final step in the ratemaking process may be taken away. (Gov. br. 40; Telcos. br. 34 n.94). This result was never intended by Congress.

The respondents concede that the States retain control over "purely intrastate" facilities, although they also assert that virtually all telephone plant is jointly used. Their concession establishes that Section 220 does not bind ratemakers for all plant reported on the FCC uniform accounts; if Section 220 concededly does not reach "purely" intrastate plant for ratemaking, then it is just as reasonable to conclude it reaches no plant allocated to the intrastate jurisdictions. In addition, although purely intrastate

plant is proportionately small, it is significant in dollar terms. In Louisiana in 1984, rates were fixed at more than $40 million for intrastate private line services, enough to cover the cost of more than $100 million in investment. *Re South Cent. Bell Tel. Co.*, Docket No. U-15955 (La. P.S.C. 1984). Michigan Bell in 1981 reported $321 million in intrastate private line investment. Ex. A-12, *Re Michigan Bell Tel. Co.*, Docket No. U-7473 (Mich. P.S.C. 1982). The respondents' concessions establish that the *Preemption Decision* was applied illegally to these facilities.

In any event, the respondents' argument would eviscerate all, or nearly all, State ratemaking jurisdiction. The States would be reduced to checking the mathematical accuracy of the revenue requirement claimed by the utility based on its books of account. The respondents try to deflect this point by claiming this is only a "depreciation" case, but the *Preemption Decision* also requires State regulators to expense 100 per cent of the affected station connection costs in the year incurred. Moreover, the accounting provisions of Section 220 are very similar to Section 220(b) and the respondents rely heavily on two of them — Sections 220(h) and (i). (Gov. br. 6; Telcos. br. 10-11, 13-14). Furthermore, the "joint use" theory applies as much to any accounting decision as it does to depreciation. Thus, if the *Preemption Decision* is approved, all FCC accounting rulings could become ratemaking decisions for the States.

The respondents concede this ramification when they proclaim that "rate design" is the only prerogative of the States. The telephone companies argue for this result, stating that Section 2(b) only preserves the right of State agencies to allocate a predetermined revenue requirement among different types of customers. (Br. 33). This contention is based on the reasoning that the reservation of State authority over "charges, classifications, practices, services, facilities, or regulations" in Section 2(b) is

equivalent to the FCC jurisdiction over "charges, classifications [and] practices" in Sections 201-05. The telephone companies interpret the FCC authority as limited to spreading the revenue requirement among different customers — *not* to adjust the per books requirement to avoid unfairness to consumers as a group. Incredibly, the Government appears to accept this theory, perhaps unwittingly. (Br. 39 n.35).

The rate design assertion is erroneous. Section 202 defines "charges" as "charges for . . . the use of common carrier lines of communication," or rates. Section 203(a) refers to "classifications, practices and regulations *affecting* such charges." *(Emphasis supplied).* The respondents concede that the depreciation and accounting classifications and practices affect rates. (Gov. br. 39; Telcos, br. 34). Therefore, Congress intended to give both the FCC and the States full ratemaking discretion in their respective spheres. In addition, it would be erroneous to conclude that Congress in 1934 wanted to curb, rather than enhance, regulatory power over monopolies.

Congress preserved more for the States than the right to regulate nonexistent plant or preside only over the final step in the ratemaking process. The arguments of the respondents are meritless.

4. The respondents virtually abandon the original FCC justification for preemption — to promote so-called "competition" in the marketplace. *Preemption Decision*, 92 F.C.C.2d 864, 877 (1983). The idea of raising rates for monopoly service to promote competition is too ludicrous to withstand the test of time. Instead, the respondents now assert that there are grave dangers and perils from State-prescribed depreciation that will discourage new investment to modernize the telephone network. (Gov. br. 12-13; Telcos. br. 24-26). This argument might make

sense in another context, but not as it applies to the telephone industry.

The companies covered by the *Preemption Decision* — the nation's largest telephone companies — are rolling in internally-generated cash. The FCC observed that in 1982 AT&T financed virtually 100 per cent of its construction program through internal generation of funds— before the *Preemption Decision*. *Prescription of Revised Percentages of Depreciation,* 96 F.C.C.2d 257, 265 (1983). Moody's reports that the Bell System in 1982 generated $16.2 billion internally and had a $16.5 billion construction program. (1984 Moody's Pub. Util. Man. 186). The electric industry, by comparison, generated only about $4.6 billion internally of $10.8 billion in construction requirements. (1985 Moody's Pub. Util. Man. al3). Moreover, the securities of the affected telephone companies are considered low in risk and rated relatively high compared to the securities of other utilities. *(See* 1985 Moody's Pub. Util. Man. a100 *et seq.*). The picture of impending doom is absurd.

In addition, the telephone companies make it very clear that their financial condition must *exceed* constitutional and statutory standards to meet their perceived needs. (Br. 27). In other words, the standards announced by this Court for ensuring fairness to investors, as well as consumers, *are not enough. See Federal Pow. Com'n v. Hope Nat. Gas Co.,* 320 U.S. 591 (1944). The carriers say they will modernize when the asserted "risk of unduly delayed cost recovery is overcome." (Br. 27). Even this assurance, however, means little; for instance, the construction program of the BellSouth companies, as a percentage of net plant, went *down* in 1983 and went *down* again in 1984, after the *Preemption Decision. (See* 1983 Moody's Pub. Util. Man. 233, 239; 1985 Ann. Rep., BellSouth Corp.) The telephone companies criticize the State

commissions for a "bland assurance" of fair rates, but their bland promise to modernize is not subject to court review. (Br. 27).

In its rush to hand cash to the telephone companies at the expense of intrastate ratepayers, the FCC did not pause to demonstrate any need for faster cash flow. If the inadequacy of intrastate depreciation could be demonstrated by evidence, the telephone companies could expect relief in State commissions and courts. But the FCC and telephone companies do not seek fairness under accepted standards; they seek a more-than-fair result by fiat.

Even if the reasoning of the FCC had credibility, which it does not, its decision still exceeds boundaries established by Congress. Therefore, the ruling is invalid. *Fidelity Fed. Sav. and Loan Ass'n v. de la Cuesta,* 458 U.S. 141 (1982); *Rice v. Santa Fe Elevator Corp.,* 331 U.S. 247 (1947).[2]

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[2] *Capital Cities Cable, Inc. v. Crisp,* 104 S.Ct. 2694 (1984), cited by the respondents, did not change the preemption analysis and did not involve restrictions placed on the FCC by Congress.

CONCLUSION

The respondents do not justify the *Preemption Decision*. Their arguments are conflicting and illogical and entail unacceptable consequences. They would overturn the regulatory principle that accounting does not bind ratemaking, jettison the "separations" dividing line created by this Court and Congress, and eviscerate the ability of state regulators to ensure fairness to consumers. Congress did not, could not, intend this result. The ruling should be reversed.

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APPENDIX A

FEDERAL COMMUNICATIONS COMMISSION

Washington, D.C. 20554

November 25, 1980

In Reply Refer To:
61730

Mr. Samuel R. Madison, Secretary
New York Public Service Commission
Empire State Plaza
Albany, New York 12223

Received
December 3, 1980
Communications
Division
Albany

Dear Mr. Madison:

The Commission, by its Order of November 6, 1980 prescribed revised depreciation rates for the plant of New York Telephone Company (NYTC).

A copy of the Order, together with the new schedule of annual percentages of depreciation, is enclosed for your information.

The following is with regard to your letters dated April 15, 1980 and May 2, 1980 to Mr. Philip L. Verveer, Chief of our Common Carrier Bureau. The FCC representatives who attended the March, 1980 depreciation meetings acknowledge that your Communications Division's staff did raise strong objections to the proposed rates for Station Apparatus-Teletypewriter and Station Apparatus-Telephone and Miscellaneous. Furthermore, your staff did indicate that they would likely challenge the use of those rates for intrastate ratemaking. Please note that the rates that we prescribed must be used by NYTC for its financial reporting; however, decisions as to the ratemaking treatment of the expenses measured by application of those rates are matters more appropriately addressed by the agency having specific jurisdiction.

Sincerely yours,

/s/ William J. Tricarico
Secretary

Enclosure